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IN THE SUPREME COURT OF THE UNITED STATES OF AMERICA

OCTOBER TERM

No._____

MARJORIE F. RIDGELY SAULSBURY,
Petitioner,

versus

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

TO THE HONORABLE FRED M. VINSON, CHIEF JUSTICE OF THE UNITED STATES, AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner respectfully shows:

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

Nature of the Action

This is a suit by the taxpayer to recover income taxes paid under protest for the years 1943, 1944 and 1945.

Jurisdiction of the District Court

It was filed in the United States District Court for the Southern District of Florida. This is the District of the taxpayer's residence. The taxes in question were paid to Wilbur O. Plummer as Acting Collector of Internal Revenue for the collection District of Indiana. At the time of the filing of this suit he was not in office, and the taxpayer's claim for refund had not been acted on for more than six months after it was filed. Jurisdiction is conferred by U. S. Code, Title 28, sec. 1331, 1346, 1402, and Chapter 646, Public Law 773.

The Proceedings in the District Court

The United States of America filed an answer. Thereafter the taxpayer plaintiff took the deposition of two witnesses in Indianapolis, and counsel for plaintiff and defendant entered into a stipulation as to the facts. None of the facts are in dispute. The case was tried before the District Court without a jury. Final judgment was entered in favor of the defendant, with findings of facts and conclusions of law incorporated in an opinion. On motion of the plaintiff, additional and modified findings of fact were made.

The Proceedings in the Court of Appeals For the Fifth Circuit

The plaintiff took an appeal to the United States Court of Appeals for the Fifth Circuit. That court af-

firmed the District Court. The opinion is dated November 10, 1952, and has not yet been reported. This petition for certiorari is directed to the opinion and judgment of the Court of Appeals.

JURISDICTIONAL STATEMENT

The Supreme Court of the United States has jurisdiction to grant certiorari by virtue of U. S. Code, Title 28, sec. 1254 (1).

The section of the Internal Revenue Code involved is 162 (b), relating to the taxability to the trustee or the beneficiary of trust income which is or is not currently distributable to the beneficiary.

The final judgment in the District Court is dated September 4, 1951. The order of the District Court making modified and additional findings of fact is dated November 5, 1951. Notice of appeal to the Court of Appeals was filed November 9, 1951. The order and opinion of the Appellate Court is dated November 10, 1952.

The nature of the case is set out in the Summary Statement of the Matter Involved, supra, and in the Question Presented and Reasons Relied upon for Allowance of the Writ of Certiorari. Briefly, the case involves the taxability of trust income to the beneficiary, not received by her, and which the trustee was forbidden to pay to her by the decree of a court of equity and probate jurisdiction of Indiana. Both the District Court and the Court of Appeals held the income withheld by the trustee pursuant to the Indiana court's decree was taxable to the beneficiary as income currently distributable to the beneficiary.

It is believed that the question involved is substantial because the answer will determine

(a) whether rules of state law as to property rights in trusts are binding upon Federal courts in tax cases under the doctrine of Erie R. R. Co. v. Thompkins;

(b) whether lower Federal courts can refuse to follow and apply prior decisions of The Supreme Court of the United States, such as Freuler v. Helvering and Blair v. Commissioner, dealing with the effect of state law upon the rights of parties subject to Federal taxation;

(c) the relative division between State and Federal governments of the power to define the property rights of taxpayers, which are or may be subject to Federal taxation.

(d) whether the lower Federal Courts may constitutionally decline to give full faith and credit to a judicial proceeding in the state court of Indiana, as directed by United States Constitution, Art. 4, sec. 1, as implemented by U. S. C. A., Title 28, sec. 1738.

STATEMENT OF THE QUESTION PRESENTED

The question presented is whether the Federal Courts can decide (a) that income of a trust is currently distributable to the life beneficiary, relying solely upon the literal terms of the trust instrument, (b) even after the

state court, dealing with the identical trust, has directed a deviation from the literal terms of the instrument in order to prevent the frustration of the primary purpose of the trust due to a change of circumstances unforeseen by the settlor.

Insofar as this question has heretofore been considered by this Court, the controlling decisions are:

Freuler v. Helvering, 291 U. S. 35

Blair v. Commissioner, 300 U. S. 5

Insofar as this question involves the supervening power of a court of equity to direct a deviation from the literal terms of a trust instrument, it is believed to be a case of first impression in this or any other Federal Court.

REASONS RELIED UPON FOR ALLOWANCE OF WRIT OF CERTIORARI TO THE COURT OF APPEALS

1. The decision of the United States Court of Appeals, in holding that Federal Courts are, in effect, free to determine whether income is currently distributable to the life beneficiary, when a state court, dealing with the same trust, has directed the trustee not to pay such income to the beneficiary, is a decision of a Federal question probably in conflict with applicable decisions of this court, to-wit: Freuler v. Helvering, 291 U. S. 35, and Blair v. Commissioner, 300 U. S. 5.

2. The decision of the United States Court of

Appeals, in holding that Federal Courts may decide that trust income is currently distributable to the life beneficiary, despite a prior decree of a state court that the trustee of the identical trust shall not pay such income to the life beneficiary, is a decision of an imporant question of local law in a way probably in conflict with applicable local decisions.

3. The decision of the lower courts denies full faith and credit to the judicial proceeding in the state court of Indiana, in which the decree referred to was entered, contrary to the provisions of United States Constitution, Art. 4, sec. 1, as implemented and made applicable to Federal Courts by U. S. C. A., Title 28, sec. 1738, and therefore is a decision which calls for the exercise of this court's power of supervision.

4. The decision of the United States Court of Appeals for the Fifth Circuit improperly places upon your petitioner the burden of showing the absence of collusion in the proceeding in the state court of Indiana, notwithstanding (a) no claim of collusion was made by the government and (b) the District Court expressly stated that no finding of collusion was made by it or considered.

WHEREFORE, your petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the United States Court of Appeals for the Fifth Circuit, commanding said Court to certify and send to this Court

a full and complete transcript of the record and of the proceedings of the said Court had in the case numbered and titled No. 13909, Marjorie F. Ridgely Saulsbury, Appellant, versus United States of America, Appellee, to the end that this cause may be reviewed and determined by this Court as provided for by the Statutes of the United States, and that the judgment herein of the said United States Court of Appeals be reversed by this Court, and for such further relief as to this Court may seem proper.

DATED this ——— day of December, 1952.

JAMES A. DIXON
908 First National Bank Building,
Miami, Florida.

JOHN G. RAUCH
1000 Fletcher Trust Building,
Indianapolis, Indiana.
Attorneys for Petitioner.

I HEREBY CERTIFY that on this —— day of December, 1952, I mailed a copy of the foregoing Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit and Brief in Support of Petition Appended Thereto, to the following:

Honorable Ellis N. Slack,
Acting Assistant Attorney General,
Washington, D. C.

Honorable Ernest L. Duhaime,
Assistant United States Attorney,
Miami, Florida.

JAMES A. DIXON,
908 First National Bank Building,
Miami, Florida,
Attorney for Petitioner.

IN THE SUPREME COURT OF THE UNITED STATES
OF AMERICA, OCTOBER TERM A. D. 1952.

No._____

MARJORIE F. RIDGELY SAULSBURY,

Petitioner,

versus

UNITED STATES OF AMERICA,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

REPORT OF OPINIONS DELIVERED IN THE COURTS BELOW

The opinion of the District Court is reported in 101 Fed. Supp. 280. The subsequent order of that court, making modified and additional findings, is dated November 5, 1951, (R. 143) and is not reported.

The opinion of the Court of Appeals is dated November 10, 1952, and has not yet been reported. It appears at R. 153.

STATEMENT OF GROUNDS UPON WHICH THE JURISDICTION OF THE SUPPEME COURT IS INVOKED

The jurisdiction of the Supreme Court is invoked upon the following grounds:

1. The decision of the United States Court of Appeals, in holding that Federal Courts are, in effect, free to determine whether income is currently distributable to the life beneficiary, when a state court, dealing with the same trust, has directed the trustee not to pay such income to the beneficiary, is a decision of a Federal question probably in conflict with applicable decisions of this court, to-wit: Freuler v. Helvering, 291 U. S. 35, and Blair v. Commissioner, 300 U. S. 5.

2. The decision of the United States Court of Appeals, in holding that Federal Courts may decide that trust income is currently distributable to the life beneficiary, despite a prior decree of a state court that the trustee of the identical trust shall not pay such income to the life beneficiary, is a decision of an important question of local law in a way probably in conflict with applicable local decisions.

3. The decision of the lower courts denies full faith and credit to the judicial proceeding in the state court of Indiana, in which the decree referred to was entered, contrary to the provisions of United States Constitution, Art. 4, sec. 1, as implemented and made applicable to Federal Courts by U. S. C. A., Title 28, sec. 1738, and, therefore, is a decision which calls for the exercise of this court's power of supervision.

4. The decision of the United States Court of

Appeals for the Fifth Circuit improperly places upon your petitioner the burden of showing the absence of collusion in the proceeding in the state court of Indiana, notwithstanding (a) no claim of collusion was made by the government and (b) the District Court expressly stated that no finding of collusion was made by it or considered.

STATEMENT OF THE CASE

This is a suit for refund of income taxes for the years 1943, 1944 and 1945, paid under protest by the petitioner. The facts giving rise to this suit are not controverted or disputed. They appear in the record in (1) two depositions taken by the plaintiff (R. 86-107), (2) a stipulation entered into between counsel (R. 108-127). Certain exhibits annexed to this stipulation are printed at R. 27, R. 43, R. 50, R. 57, R. 61, R. 64, where they appear as exhibits attached to the complaint. The depositions were offered into evidence (R. 127).

Henry D. Ridgely, the petitioner's husband, created an inter vivos trust, as to which the petitioner was the life beneficiary of income. The trust instrument is printed at R. 27, and a modifying instrument at R. 43.

After her husband's death, the petitioner for a time acted as his executrix, but resigned and was discharged (Paragraph IV of Stipulation, R. 110-111) and was succeeded by one Ward as administrator c. t. a., d. b. n. Ward paid the Indiana and Federal estate taxes shown to be due by the returns for these purposes (R. 111) and disclosed the facts with reference to the inter vivos trust (R. 112).

Subsequently, the Commissioner of Revenue proposed a deficiency in the estate tax, arising out of his contention that the value of the inter vivos trust was a part of the decedent's gross estate, Mr. Ward and the trustee filed a joint protest, and eventually a deficiency tax was assessed, based upon the inclusion of a part of the value of the inter vivos trust in the decedent's gross estate (R. 112-113). The amount of the deficiency, with interest, was $101,905.00. The notice of deficiency was directed to American National Bank at Indianapolis, as the trustee of the inter vivos trust.

At that time, the assets of the trust consisted of $26,896.07 in cash and 12,500 shares of the common stock of Eli Lilly & Co., an Indiana corporation (R. 52). Faced with the necessity of raising over $100,000.00 immediately, the trustee obtained a short extension of time, and applied to the Probate Court of Marion County, Indiana, for instructions (deposition of Rogan, R. 98-99).

A peculiar situation existed at that time. The Eli Lilly & Co. was closely held by members of the Lilly family and executives of the corporation, and there was no market (deposition of Rogan, R. 100). In fact, none of this stock had been traded in for more than 20 years (deposition of Collett, R. 91). No financial statements were ever published or even furnished to stockholders (R. 91). Furthermore, the corporation was at that time engaged in full capacity production of of penecillin, with excellent prospects, but with the then existing excess profits tax, the profit potentialities were still potential only, and would continue to be only potential until the expiration or repeal of that tax (R. 100; R. 91).

At the time Mr. Ridgely created the inter vivos trust in 1930 and amended it in 1936, neither the discovery of antibiotics on a commercial scale nor the imposition of the excess profits tax could have been anticipated by him. In the 1936 amendment to the trust, Mr. Ridgely had (R. 46) directed that any estate tax assessed against the trust be paid out of corpus, but due to the three factors mentioned above, viz: lack of market, commercial development of antibiotics, and the excess profits tax, it was obviously unwise for the trustee in 1944 to have followed the literal terms of the trust instrument. Indeed, to have done so might have greatly jeopardized the interests of the remaindermen, a class as of that time not ascertained, by a sale at a sacrifice.

Under these circumstances, the trustee who had previously been represented by the donor's and beneficiary's attorney, recognized a possible conflict of intest and employed independent counsel (R. 101). A petition for instructions was filed in the appropriate Indiana court. The beneficiary was notified and appeared by counsel (R. 102).

After hearing testimony (R. 102-103), the Indiana court directed the trustee to borrow $100,000.00, pay the estate tax deficiency, and to repay the loan out of income (R. 58-59) and until the loan was repaid, not to pay any income to the beneficiary (R. 59). The trustee reported its compliance with the order (R. 61-63) and its actions were confirmed (R. 64-66).

Thereafter, the trustee reported the income of the trust, and paid the tax thereon (Paragraph VI of Stipulation, R. 116). At the same time, the beneficiary reported no income from the trust (R. 117). However, the Com-

missioner assessed an income tax deficiency against the beneficiary for the years during which the income of the trust was used to repay the loan, on the theory that, notwithstanding the decree of the Indiana court, the income was distributable to her.

SPECIFICATION OF ERRORS

1. The District Court erred in entering judgment against your petitioner and in refusing to enter judgment in her favor.

2. The Court of Appeals erred in affirming the judgment of the District Court, and in refusing to reverse.

SUMMARY OF ARGUMENT

1. The decree of the Indiana court declares the law of that state and established the property rights of the beneficiary and remaindermen, as well as the trustee, in the assets and income of the trust, and under the rule of **Erie R. R. Co. v. Thompkins**, that law is binding upon the Federal courts.

2. Both the District Court and the Court of Appeals refused to follow and apply prior decisions of this court, **Freuler v. Helvering**, 291 U. S. 35, and **Blair v. Commissioner**, 300 U. S. 5, which hold that state law determines what the property rights of taxpayers are.

3. Both the District Court and the Court of Appeals denied full faith and credit to the

judicial proceedings in the Indiana court, in contravention of U. S. Constitution, Art. 4, sec. 1, as implemented and made applicable to Federal Courts by U. S. C. A., Title 28, sec. 1738.

4. The Court of Appeals erroneously cast upon your petitioner the burden of affirmatively showing lack of collusion in the entry of the Indiana decree, when the lower court expressly made no finding on that subject, and when the record in fact shows no collusion.

ARGUMENT

1. Te decree of the Indiana court declares the law of that state and established the property rights of the beneficiary and remaindermen, as well as the trustee, in the assets and income of the trust, and under the rule of **Erie R. R. Co. v. Thompkins,** that law is binding upon the Federal Courts.

The decree of the Indiana court directed a deviation from the literal terms of the trust in pursuance of the power of equity to do so to prevent a frustration of the primary purpose of the trust due to a change of circumstances unforeseen by the settlor.

This power is neither new nor novel. It is well established law. See **2 Scott on Trusts,** sec. 167, and **3 Scott on Trusts,** sec. 381. It is the law of Indiana. See **Faust v. William E. English Foundation,** 80 N. E. (2) 303. It is the law of Florida. See **Griley v. Marion Mortgage Company,** 187 So. 297.

In this case, the law of Indiana has been declared by the Indiana court with reference to this very trust, on the identical facts. By the effect of this decree, the life beneficiary has lost the income from the trust for a number of years. The loss is irretrievable. At the same time the corpus has been preserved intact for the remaindermen. The property rights of both have been altered and determined.

The District Court held **(101 F. Supp. at page 284)** that the Indiana decree should be disregarded, and that the Federal Court could determine the property rights of the petitioner during the years in question (R. 136).

The Court of Appeals said (R. 156):

> "The order of the State Court . . . .is not entitled to any weight, since it did not determine the rights of the parties under the trust instrument."

It is submitted that both courts are in error, and that in holding the trust income distributable despite the decree of the state court directing it not to be paid, they in effect are proceeding upon a Federal common law rule, not the law of the state.

There is no Federal common law.

Erie Railroad Co. v. Thompkins, 304 U. S. 64.

It is further submitted that in so holding, both lower courts have decided an important question of local law in a way in conflict with applicable local decisions.

2. Both the District Court and the Court of Appeals refused to follow and apply prior decisions of this court, **Freuler v. Helvering,** 291 U. S. 35, and **Blair v. Commissioner,** 300 U. S. 5, which hold that state law determines what the property rights of taxpayers are.

This court, in **Freuler v. Helvering,** 291 U. S. 35, held that the decree of a California court directing a trustee to set up a reserve for depreciation out of trust income was binding upon the Commissioner and the Federal courts.

In **Blair v. Commissioner,** 300 U. S. 5, this court held that the decree of an Illinois court that a trust was not spendthrift in nature, and hence a beneficiary could assign his income was likewise binding on the Commissioner and the Federal courts.

These two cases are, it is submitted, controlling, in principle, of the present case. Their authority has not been undermined by cases like **Lyeth v. Hoey,** 305 U. S. 188, or **U. S. v. Pelzer,** 312 U. S. 399. See **Helvering v. Stuart,** 317 U. S. 154, at page 162.

The lower courts refused to apply the principles of the Blair and Freuler cases. The Indiana decree here created rights and interests in the trust income, and, therefore, is squarely within the reasoning of both cases.

3. Both the District Court and the Court of Appeals denied full faith and credit to the judicial proceedings in the Indiana court, in contravention of U. S. Constitution, Art. 4, sec. 1, as implemented and made applicable to

Federal Courts by U. S. C. A., Title 28, sec. 1738.

U. S. Constitution, Article 4, sec. 1, provides that full faith and credit be given to the judicial proceedings of a state in every other state. U. S. C. A., Title 28, sec. 1738, provides:

> "Such acts, records and judicial proceedings . . . . shall have the same full faith and credit in every court within the United States . . . .as they have by law or usage in the courts of such state . . . . from which they were taken."

Unquestionably, the proceedings leading up to the Indiana decree were judicial, and are the present day equivalent of the well known equity bill by a trustee for instructions. The life beneficiary was notified and appeared at the hearing by counsel. Testimony was taken before the court (R. 57, R. 65, R. 102-103). The decree terminated the right of the life beneficiary to receive income during the years in question. It preserved for the remaindermen a portion of the corpus which otherwise would have been sold. It was entered in a court of appropriate jurisdiction.

If it was a judicial proceeding, then it was entitled to the same full faith and credit in the Federal Courts as it was in Indiana. To disregard it, as the lower courts here did, is to say that in Indiana it would have had no effect. Such a conclusion is unthinkable, since it treats the decree as a complete nullity, in Indiana and everywhere.

We submit that this situation calls for the exercise by this court of its power of supervision.

4. The Court of Appeals erroneously cast upon your petitioner the burden of affirmatively showing lack of collusion in the entry of the Indiana decree, when the lower court expressly made no finding on that subject, and when the record in fact shows no collusion.

The District Court, in its order for additional and modified findings of fact, expressly stated (R. 144) that it had not considered whether the proceeding in the Indiana court was collusive or non-collusive. The Court of Appeals (R. 157) places a burden upon the petitioner of "affirmatively" showing that there was no "collusion" in the Indiana proceeding.

There was nothing in the Government's pleadings to put the petitioner on notice that any claim of collusion would be made. It does affirmatively appear that the trustee, when confronted with the necessity of raising more than $100,000.00 immediately, took independent legal counsel because of the possible adverse effect of its contemplated action upon the life beneficiary (R. 101). The life beneficiary was notified of the application to the court and appeared by counsel. Testimony was heard and unquestionably the life beneficiary was given an opportunity to cross-examine and to introduce testimony.

The Court of Appeals defines "collusion" as the lack of a "genuine issue of law or fact as to the right of the beneficiary to receive this income." This statement assumes two things — first, that facts existed contrary to those alleged by the trustee and testified to before the court, and second, that the law of Indiana was contrary to that applied by the court. Neither assumption has any shred of support in the record.

In fact, every allegation of the trustee's petition for instructions is covered by the stipulation of fact. And the power of the Indiana court to direct a deviation from the literal terms of a trust instrument has been expressly declared by an appellate court of the state. **Faust v. William E. English Foundation,** 80 N. E. (2) 303, at page 311. At the same time, a trustee cannot lawfully deviate from the literal terms of the trust merely because the facts are not in dispute. The right and power to do so are conferred upon him by the court. See **2 Scott on Trusts,** sec. 167.

If there was no "genuine issue of law or fact" it was because the facts alleged by the trustee were true and the law applied by the court was truly the correct law of the state. So far from detracting from the weight and binding effect of the decree, this should add to its effect.

Your Honors are respectfully urged to grant the petition for the Writ of Certiorari.

Respectfully submitted,

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Indianapolis, Indiana.

JAMES A. DIXON,
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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 529

MARJORIE F. RIDGELY SAULSBURY, *Petitioner*

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 128-139) is reported in 101 F. Supp. 280. The order of the District Court amending its opinion (R. 143-145) is not reported. The opinion of the Court of Appeals (R. 152-156) is reported in 199 F. 2d 578.

JURISDICTION

The judgment of the Court of Appeals was entered on November 10, 1952. (R. 156.) The petition for a writ of certiorari was filed on January 2, 1953. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the net income of a trust which the trust instrument directs shall be paid in monthly installments to the beneficiary is income currently distributable to her and, therefore, taxable to her under Section 162 (b) of the Internal Revenue Code, notwithstanding that such income was not received by her but was used, under the authority of a state court order, to repay a loan, the proceeds of which were used to pay estate taxes on the corpus of the trust.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 162. NET INCOME.
>
> The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—
>
> * * * * *
>
> (b) [as amended by Sec. 111 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798] There shall be allowed as an additional de-

duction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

* * * * *

(26 U.S.C. 1946 ed., Sec. 162.)

STATEMENT

The taxpayer, Marjorie F. Ridgely Saulsbury, is the widow of Henry D. Ridgely. Prior to his death her husband established a trust, the corpus of which consisted of shares of the common capital stock of Eli Lilly and Company, a drug manufacturer. This trust (referred to herein as the Ridgely Trust) was established on June 19, 1930, and amended on April 23, 1936. Under the

terms of the trust agreement, as amended, the trustee was directed to pay the net income to the donor for life and upon his death to "pay the net income from the trust estate in monthly installments to Marjorie Fletcher Ridgely, the wife of the Donor, for and during the term of her natural life". (R. 92, 128-129.) The trustee was further directed to pay over to the donor's wife one-half of the corpus of the trust upon the death of the donor; to hold the remainder of the corpus subject to her power of appointment; and to "pay, out of the corpus, any and all death duties, estate tax, * * * which may be laid * * * upon any assets constituting the whole or any portion of the corpus of this trust". (R. 129-130.)

Mr. Ridgely died on March 29, 1942. His will made his wife his executrix and residuary legatee. As residuary legatee she received assets of the estate having a value of $9,179.73. (R. 130.) In accordance with the terms of the Ridgely Trust she also received on April 13, 1942, half the corpus of the trust. She received 12,500 shares of stock in Eli Lilly and Company. (R. 51-52.)

The estate tax return filed for the estate of Mr. Ridgely did not include in the gross estate the property in the Ridgely Trust, which was found by the Commissioner of Internal Revenue to have a value of $525,751. In July, 1944, a deficiency of $97,180.44, together with interest of $4,724.56, was assessed against the trustee of the Ridgely

Trust based upon the inclusion within the gross estate of Mr. Ridgely of 65.183 per cent of the value of the trust. A further assessment of interest was made in September, 1944. (R. 130-131.)

In September, 1944, the corpus of the trust consisted of 12,500 shares in Eli Lilly and Company, which had not been distributed to taxpayer, and some cash. (R. 51-52.) According to evidence submitted by the taxpayer, Eli Lilly and Company is a closely held corporation and its shares are not traded on the open market. Because of the demand for drugs created by the war and for other reasons, it was anticipated that the company's business would experience large profits which would redound to the benefit of the stockholders whenever the excess profits tax was lifted. (R. 91, 100.) To avoid the necessity for selling any of the stock held by the Ridgely Trust in order to pay the estate taxes, the trustee filed in the Marion Probate Court of Indiana, on September 8, 1944, a "Petition to Pay Estate and Inheritance Taxes and to Borrow Money for such Purposes". (R. 50-55, 101-102.) The petition set out the terms of the trust instrument and recited that the entire assets of the trust consisted of shares in Eli Lilly and Company and $26,896.07 in cash; that a deficiency assessment had been levied against the estate by the Collector of Internal Revenue; that, in order to pay this assessment and certain additional Indiana inheritance taxes, the

trustee would have to borrow $90,000, on a note payable on or before five years, with interest; that this loan was to be secured by a pledge of the shares of stock in the trust; and that all dividends received on such stocks would be used to repay the loan.

The taxpayer was notified of the filing of this petition and appeared by counsel at the hearing held by the probate court on the petition. (R. 102-103.) On the same day that the petition was filed, the probate court entered an order directing payment of the federal and state taxes, authorizing the trustee to borrow $90,000 and to pledge the shares of Eli Lilly and Company as security for the loan, directing it to use all the dividends received on such stock from the 16th day of September, 1942, to repay the loan and further directing the trustee, until the loan was repaid, to "make no further payments of income of any kind or character to the life beneficiary of said trust". (R. 57-59.) Upon entry of the order the stock was pledged and the loan made. It was repaid June 20, 1950. (R. 104.)

In the income tax returns filed by the trustee of the Ridgely Trust for the years 1942-1945, no income was reported as distributable to Mrs. Saulsbury, and no deduction was taken for such income. Similarly the taxpayer, in filing her returns for the years 1943-1945, did not include any income from the trust. (R. 117, 133.)

Upon examination of these returns, the Commissioner determined that the net income of the trust was distributable to the taxpayer. Accordingly, he advised the trustee of over-assessments for the years on which it had paid income taxes on the net income of the trust and advised the taxpayer of deficiencies for the years 1943, 1944 and 1945. The Commissioner assessed a total deficiency for these three years of $31,866.60, together with interest of $7,293.20. This sum was paid under protest and thereafter this suit for refund was filed. (R. 118, 133.)

The District Court entered judgment for the United States. (R. 139-140.) The court held that under the terms of the trust instrument the income of the trust was currently distributable to the taxpayer and hence she was taxable thereon. (R. 134-137.) The Court of Appeals affirmed. (R. 156.)

ARGUMENT

This case presents no question of general importance in the administration of the tax laws. Both courts below correctly held that the taxpayer, as the life beneficiary of a trust under which the net income was distributable monthly to her, was taxable on such income under Section 162 (b) of the Internal Revenue Code, *supra*, pp. 2-3, even though under an order of the State probate court, apparently entered without objection by her, she did not receive such income during

the years involved. There is no conflict of decisions on this question.

1. Section 162 (b) of the Internal Revenue Code provides that income which is currently distributable to the beneficiary of a trust is to be deducted from the net income of the trust and is to be included in the net income of the beneficiary, whether distributed or not. Under the statute, the "test of taxability to the beneficiary is not receipt of income, but the present right to receive it". *Freuler* v. *Helvering,* 291 U. S. 35, 42. Consequently, in determining taxability, it is immaterial that the beneficiary has not received the income in question and that it has been withheld by the trustee by agreement, through mistake of law, or for any other reason. *Doty* v. *Commissioner,* 148 F. 2d 503 (C.A. 1st); *DeBrabant* v. *Commissioner,* 90 F. 2d 433 (C.A. 2d); *Malcom* v. *Commissioner,* 97 F. 2d 381 (C.A. 2d); *Bedford* v. *Commissioner,* 150 F. 2d 341 (C.A. 2d); *Bryant* v. *Commissioner,* 185 F. 2d 517 (C.A. 4th); *McCrory* v. *Commissioner,* 69 F. 2d 688 (C.A. 5th); *Loggie* v. *Thomas,* 152 F. 2d 636 (C.A. 5th); *Cope* v. *Commissioner,* 80 F. Supp. 534 (E.D. Pa.).

The only pertinent inquiry is: Do the terms of the trust instrument create a right in the beneficiary to the net income of the trust? It is clear that the trust instrument here involved creates such a right. In plain and unambiguous language it directs the trustee to "pay the net income from

the trust estate in monthly installments" to the taxpayer. (R. 45-46.) Both lower courts were therefore correct in holding that since the income under the trust was by the terms of the trust currently distributable to the taxpayer, she was taxable on it.

2. The taxpayer renews here the argument, unsuccessfully made in the courts below, that an order entered by the local Indiana probate court having jurisdiction over the administration of the trust constitutes an adjudication which is binding on the federal courts and compels a contrary result to that reached below. (Pet. 15-18.) This argument is without merit. The order of the probate court cannot carry the weight the taxpayer places on it. Concededly, an authoritative declaration by a state court as to the nature and extent, under state law, of the rights created by a particular trust instrument is binding upon the federal courts. *Freuler* v. *Helvering,* 291 U.S. 35; *Blair* v. *Commissioner,* 300 U. S. 5; *Helvering* v. *Stuart,* 317 U. S. 154. In this case, however, as both courts below observed, the order of the Indiana probate court did not purport to determine the rights of the parties under the trust instrument. No question as to the construction of the trust instrument was submitted to or passed on by the court. All that the Indiana court was requested to do, and did, was to authorize a temporary disposition of the funds and income of the trust, which disposi-

tion was obviously to the benefit of the only interested party, the beneficiary of the trust, and to which she interposed no objection. Pledging the corpus of the trust and using the income therefrom to pay the estate taxes, rather than selling a portion thereof to pay such taxes as the trust instrument directed, benefited the taxpayer in that it preserved the principal intact and thus increased her future income. In addition, payment of her husband's estate taxes in this manner preserved the assets of the estate already distributed to her from a lien for the unpaid taxes.[1]

There is nothing in the record of the probate court, in so far as it was placed in evidence here, to suggest that the probate court was undertaking to authorize a deviation from the trust, as the taxpayer now suggests. (Pet. 15.) The petition submitted to that court (R. 50-55) is completely devoid of the allegations essential to a petition seeking authority to deviate from the terms of a trust because circumstances not known to the settlor and not anticipated by him have impaired accomplish-

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[1] In the court below it was argued on behalf of the Commissioner that, even if the taxpayer was not taxable on the income from the trust under Section 162 (b), she was taxable under Section 22 (a) of the Code. This argument was predicated upon the taxpayer's personal liability for the estate taxes arising out of her receipt of the assets of the estate. Because of the view the court below took of the case, it never reached this question (R. 156), but should this Court grant certiorari this argument will be renewed here.

ment of the purposes of the trust. *Foust* v. *William E. English Foundation,* 118 Ind. App. 484, 502. Nor would the facts have supported such a petition.[2] Viewing the proceeding in its entirety, it is clear that all the probate court did was give its *pro forma* approval to a course of action which appeared desirable to all the interested parties. Had the trustee and the beneficiary simply agreed to pledge the assets of the trust and to use the net income therefrom to repay such loan, the taxpayer would nonetheless have been taxable on such income. *Malcom* v. *Commissioner,* 97 F. 2d 381 (C.A. 2d); *Bryant* v. *Commissioner,* 185 F. 2d 517 (C.A. 4th). The fact that a probate court was requested to and gave its approval to such an arrangement does not alter

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[2] The only change in circumstances between April, 1936, when the settlor of the trust amended it so as to require sale of the corpus of the trust to pay the estate taxes, and September, 1944, when the trustee requested the probate court for permission to pledge the assets of the trust to raise money to pay such taxes, was the unusually favorable profit position of Eli Lilly and Company, whose stock constituted the corpus of the trust. Otherwise, all the surrounding circumstances which led the trustee to conclude that sale of the corpus would be unwise were identical with what they had been at the time the settlor directed such sale. In 1936, as in 1944, the stock of Eli Lilly and Company was closely held and not traded on the market. The trustee was undoubtedly justified in considering the direction to sell the stock unwise, but such lack of wisdom was not the product of any change in the significant surrounding facts since 1936. Expediency alone will not justify deviation from the terms of a trust. See 1 Restatement of the Law, Trusts, Sec. 167 (1), Comment (b).

the substance of the case and should not change the result. In rejecting the order of the probate court as dispositive, the court below observed that it did not appear that there was no "collusion" in securing it. (R. 154-155.) As the court's opinion makes clear (R. 155), by "collusion" is not meant improper conduct and no burden is cast upon the taxpayer to show the contrary (Pet. 19-20), but simply that the proceeding before the probate court was not of such an adversary character as to result in a considered adjudication on the merits determining a contested legal issue.

The other Courts of Appeals are in accord with the court below in refusing to recognize as binding upon them decrees of state courts entered in similar circumstances. The Court of Appeals for the Third Circuit has consistently held that the federal courts are bound only by an adjudication of a state court entered upon the merits of the matter in question. Consequently, in determining whether a claim against a decedent's estate is deductible it has refused to treat as controlling the fact that the local probate court had entered an order *pro forma* approving payment of it. *First-Mechanics Nat. Bank* v. *Commissioner,* 117 F. 2d 127. In deciding whether a decedent died possessed of a fee or life tenancy, it has not deemed itself bound by an order of a local probate court describing the decedent's interest as being a life tenancy. *Commissioner* v. *Childs' Estate,* 147

F. 2d 368. And, in determining whether income under a trust is taxable to the beneficiary, it has rejected as controlling an order of the probate court embodying a construction of the trust instrument different from that placed upon it by the Court of Appeals. *Falk* v. *Commissioner,* 189 F. 2d 806, certiorari denied, 342 U. S. 861. The Court of Appeals for the Seventh Circuit has similarly refused to accept as decisive, in determining whether a valid trust had been created, a decree of an Illinois state court construing the trust. *Brainard* v. *Commissioner,* 91 F. 2d 880. In reliance upon certain of these decisions, among others, the Court of Appeals for the First Circuit recently refused to predicate a decision construing a trust upon a decree of the local probate court but found the state law independently. *Channing* v. *Hassett,* decided December 31, 1952 (1953 C.C.H., par. 9154). See also, *Loggie* v. *Thomas,* 152 F. 2d 636 (C.A. 5th); *Mississippi Valley Trust Co.* v. *Commissioner,* 72 F. 2d 197 (C.A. 8th), certiorari denied, 293 U. S. 604; and *Daine* v. *Commissioner,* 168 F. 2d 449, 452 (C.A. 2d). A different result is, of course, reached when the decree of the state court is an adjudication upon the merits in an adversary proceeding. Its binding character upon the questions of local law determined by the state court is, in such circumstances, uniformly recognized. *Kelly's Trust* v. *Commissioner,* 168 F. 2d 198 (C.A. 2d); *Thomas*

Flexible Coupling Co. v. *Commissioner,* 158 F. 2d 828 (C.A. 3d), certiorari denied, 329 U. S. 810; *Eisenmenger* v. *Commissioner,* 145 F. 2d 103 (C.A. 8th).

CONCLUSION

The decision below is correct; there is no conflict of decisions; and no question of general importance is involved. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. 529

MARJORIE F. RIDGELY SAULSBURY,
Petitioner

v.

UNITED STATES OF AMERICA,
Respondent.

BRIEF OF THE STATE OF INDIANA, AS AMICUS CURIAE, IN SUPPORT OF PETITIONER'S APPLICATION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Report of Opinions Delivered in the Courts Below

The opinion of the District Court is dated August 30, 1951 and is reported in 101 Fed. Supp. 280.

The opinion of the Court of Appeals is dated November 10, 1952 and is reported in 199 Fed. 2nd. 578.

STATEMENT OF THE GROUNDS UPON WHICH THE STATE OF INDIANA RELIES TO SUPPORT ITS POSITION AS AMICUS CURIAE AND TO INVOKE THE JURISDICTION OF THE SUPREME COURT.

1. The State of Indiana, as one of the sovereign states of the Federal Union, is accorded the unrestricted privilege under Rule 27, Subparagraph 9, of the rules of the Supreme Court, of filing a Brief as amicus curiae.

2. The United States Court of Appeals for the Fifth Circuit in the above entitled case has rendered a decision (199 Fed 2nd. 578) which denies full faith and credit to a judicial proceeding of one of the Courts of Record of the State of Indiana, namely, the Probate Court of Marion County, Indiana, (Rec. pp. 57-59).

3. The United States Court of Appeals for the Fifth Circuit in the above entitled case has rendered a decision (199 Fed. 2nd. 578) which denies full faith and credit to a Statute of the State of Indiana, namely, Acts of Indiana, 1931, Cr. 75, Sec. 16, p. 192, 207; Burns Ind. Stat. Ann. 1933, Sec. 6-2416.

4. The United States Court of Appeals for the Fifth Circuit in the above entitled case has rendered a decision (199 Fed. 2nd. 578) which is in conflict with a ruling precedent of the Supreme Court, namely, *Freuler v. Helvering,* 291 U. S. 35.

5. The United States Court of Appeals for the Fifth Circuit in the above entitled case has rendered a decision (199 Fed. 2nd. 578) which is in conflict with the Constitution of the United States, Art. 4, Sec. 1, and the provisions of Title 28, Sec. 1738, U. S. C. A. of the Statutes of the United States.

STATEMENT OF THE POSITION OF THE STATE OF INDIANA

The State of Indiana is not interested in the private aspects of this appeal. The Petitioner is a citizen of the State of Florida, and is represented by counsel so far as her private rights are concerned. This brief is confined solely to the public aspects of the decision sought to be reviewed, and does not purport to brief all aspects of the appeal.

STATEMENT OF THE ASPECT OF THE CASE IN WHICH THE STATE OF INDIANA IS CONCERNED.

A careful examination of the Record discloses that the following facts are undisputed:

1. On September 8, 1944 the Probate Court of Marion County, Indiana, entered its Decree directing the Trustee of the Ridgely Trust to discontinue payment of income to Marjorie Saulsbury, the life beneficiary of income, until a debt incurred to pay taxes assessed against the Trustee be paid in full (R. pp. 57-59).

The Probate Court of Marion County is a court of general jurisdiction of the State of Indiana, invested by statute with jurisdiction over trusts.

The Court, in the proceeding in question, acquired jurisdiction by due process of law over the parties to the proceeding, namely, the Trustee and the beneficiary. Its Decree in that proceeding, adjudicating payment of income by the Trustee, is the law governing the Ridgely Trust, and is accorded full faith and credit in the State of Indiana.

There is no evidence of any fraud or collusion in the proceeding. The ~~Circuit~~ Court stated it did not affirmatively appear that there was no collusion. Under the full

faith and credit clause, one attacking a judgment collaterally has the burden to show fraud. There is no burden to show no collusion or fraud. Error cannot be presented on a collateral attack, otherwise a federal court would become an appellate court to review the decisions of state trial courts for error.

There is no federal question involved in the Probate Court proceeding, and the Federal Courts have no jurisdiction to review the decision of the Probate Court, either directly or indirectly. The proceeding in Probate Court was of exclusive cognizance by the State Courts, and their jurisdiction cannot be questioned in a federal court in another state or in this appeal. No Indiana court could have questioned the correctness of the Probate Court decision save by an appeal; and in a collateral proceeding a federal court should not be permitted to do so.

The Court of Appeals disregarded the decision of the Indiana Probate Court and gave it no weight whatsoever.

2. At the time the Trustee was confronted with the problem of paying additional Federal Estate taxes and Indiana Inheritance taxes (Sept. 1944), there was in full force and effect an Indiana Statute (Burns Ind. Statutes Ann. 1933, Sec. 6-2416) which expressly forbids a fiduciary to pay or distribute any property subject to the tax until he shall have paid the tax.

SUMMARY OF ARGUMENT

1. The question is whether the Court of Appeals denied full faith and credit to the Probate Court decree of September 8, 1944, in contravention of Art. IV, Sec. 1 of the United States Constitution and of 28 U. S. Code, Sec. 1738.

2. The Court of Appeals took no notice of, and thus denied full faith and credit to the following Statute of the

State of Indiana: Burns Ind. Stat. Ann. 1933, Sec. 6-2416, which reads, in part, as follows:

> "He shall not deliver, or be compelled to deliver any specific legacy, or property, subject to tax, under this act, to any person until he shall have paid the tax thereon . . ."

ARGUMENT

Article IV, Sec. 1 of the Constitution of the United States, and 28 U. S. Code Ann., Sec. 1738 of the United States Judicial Code provide that the Acts and Judicial Proceedings of any State are entitled to the same full faith and credit in the Courts of the United States as they are accorded in the State of their origin.

The decision in *Freuler v. Helvering,* 291 U. S. 35, gives judicial effect to the same principle.

The Decree of the Probate Court of Marion County is given full faith and credit in the State of Indiana.

This decree is the law of Indiana so far as relates to payment of income by the Trustee of the Ridgely Trust during the years in suit in this case. No Court or official in the State of Indiana can question its validity or effectiveness, save in a proper appellate review thereof.

It is the duty of the Federal Courts likewise to accord this decree the same full faith and credit as is accorded to it in the State of Indiana. This the decision of the Court of Appeals for the Fifth Circuit failed to do.

The pertinent language of the opinion of the Court of Appeals to which exception is taken by the State of Indiana appears at page 580, subdivision (3) of the opinion, as follows:

> "The order of the State Court directing that no further payments of income be made to appellant until said loan was paid, we think, is not entitled to any weight . . ."

The Court of Appeals said that it did not affirmatively appear there was no collusion. The burden in a collateral

attack is on the one making the attack to show want of jurisdiction or fraud.

Next the Court proceeds to impeach the Probate Court decree by saying there was no genuine issue presented to the Court for decision. The record shows the issue presented was how the trustee could find cash with which to pay Federal and State taxes without irreparable damage to the corpus of the trust? This issue was decided by the Probate Court's decree, which took income from the income beneficiary and used it to pay the tax debt. The Court of Appeals takes the position of retrying the issue decided by the Probate Court and reaches a different conclusion. The Probate Court took away income from the income beneficiary; the Court of Appeals, in effect, restored this income, and then proceeded to lay an income tax upon it, although admitting that the income beneficiary never received the income actually or constructively. This is a collateral attack, no matter by what name it is called. The Probate Court decree specifically said: "that the Trustee shall make no further payments of income of any kind or character to the life beneficiary of said trust." This was a final order binding on Indiana courts.

This decision of the Probate Court is a constructive assignment of the income of the trust by the life beneficiary to the Trustee. It has been held in the case of *Farkas v. Commissioner,* 170 Fed. (2nd) 201, following the rule of *Blair v. Commissioner,* 300 U. S. 5, that where income is assigned it is taxable to the assignee and not to the assignor. If the Court of Appeals had wanted to give effect to the Probate Court decree it could readily have done so on this theory because that was the net result of the proceeding, but this point was not considered in the opinion.

2. Furthermore, the Court of Appeals totally disregarded a Statute of the State of Indiana (Burns Ind. Stat. Ann. 1933, Sec. 6-2416) which provides that no fiduciary shall deliver any property to a beneficiary so long as Indiana Inheritance taxes remain unpaid. This statute seems to have been wholly overlooked when the Court of Appeals wrote its opinion. It is nowhere mentioned. The District Court in its opinion noticed the statute, but disregarded it, for the reason that it had not been construed in any Court opinion. An Indiana statute does not depend upon being construed by a court to have effect or validity.

It is submitted that the opinion of the Court of Appeals disregards this Statute, and says, in effect, that the Trustee could under the Trust Indenture have distributed the income in the face and contravention both of the plain provisions of the Probate Court decree and the Statute.

The proper functioning of the scheme of dual government which we have adopted in this country depends upon a nice and proper observance by both the National and State governments of the rights and prerogatives of the other.

The State of Indiana considers the Saulsbury case to be of significance, and invites the Supreme Court to review the basic rules involved in reconciling the concurrent claims of the Federal and State Governments to construe transactions affecting income. These transactions are governed by State law as to substance, and by Federal law only as to resulting taxation. It is most awkward when the State Courts take one position and the Federal Courts another. It was to remedy this possibility of con-

fusion in other areas that the Supreme Court adopted the rule in *Erie Ry. v. Tompkins,* 304 U. S. 64. It is suggested that a similar rule be applied to tax cases.

In the Saulsbury case the Probate Court of Marion County, Indiana, adjudicated the right to receive income during the years in question from the Ridgely Trust, and denied the income beneficiary the right to receive income so long as the tax liens on the trust corpus were unpaid. This was done in a judicial proceeding conducted in accordance with Indiana practice, and all interested persons were made parties thereto. The Probate Court had absolute jurisdiction of the subject matter. The Federal Government was not a necessary or proper party thereto, and could not properly have been made a party thereto, but it is, none-the-less, bound under the rule of Comity to recognize the income status of the Ridgely Trust as determined by the Probate Court, and to give full faith and credit to the Probate Court's decree. This the Court of Appeals declined to do.

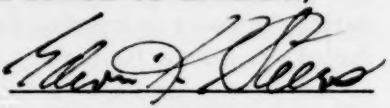
There is also the question of the Statute Law of Indiana relating to the duties of the trustee which is disregarded in the District Court and the Court of Appeals.

For these reasons the law officers of the State of Indiana consider it to be their duty to file this Brief on behalf of the State of Indiana, as amicus curiae, and to ask that the Supreme Court may be pleased to grant its Writ of Certiorari so that this appeal may be heard and the decision of the Court of Appeals for the Fifth Circuit be reversed and this cause remanded to the District Court of the United States for the Southern District of Florida, with

instructions to give full faith and credit to the acts and judicial proceedings of the State of Indiana.

Respectfully submitted,

THE STATE OF INDIANA,

BY 

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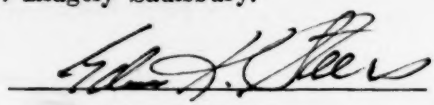
I, the undersigned, hereby certify that on February 11, 1953 I mailed three copies of the annexed Brief to the Solicitor General of the United States at Washington, D. C. and that I mailed three copies to counsel of record for the Petitioner, Marjorie F. Ridgely Saulsbury.



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